No. 92-74

In The

Supreme Court of the United States

October Term, 1993

DEPARTMENT OF REVENUE OF THE STATE OF OREGON, RICHARD A. MUNN, in his Capacity as Director of the Department of Revenue of the State of Oregon,

Petitioner,

vs.

ACF INDUSTRIES, INC., ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF STATE OF IOWA AS AMICUS CURIAE IN SUPPORT OF PETITIONER DEPARTMENT OF REVENUE

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QUESTIONS PRESENTED FOR REVIEW

I. Is An Ad Valorem Tax "Any Other Tax" Subject To Section 306(1)(d) Of The Railroad Revitalization And Regulatory Reform ("4-R") Act Of 1976?

II. Do The Restrictions On Disparate Impact In Ad Valorem Taxes Found In 4-R Act Sections 306(1)(a) And 306(1)(c) Preempt Additional Disparate Impact Discrimination Analyses Of Ad Valorem Taxes Under Section 306(1)(d)?

III. Does Pervasive Disparate Impact Regulation Preempt All Other Discrimination Analyses Of Ad Valorem Taxes Under Section 306(1)(d) Of The 4-R Act?

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INTEREST OF THE AMICUS CURIAE

Amicus State of Iowa submits this brief in support of Petitioner,[1] Department of Revenue of the State of Oregon

[1] Iowa concurs in the briefs submitted by Petitioner and Amici State of Washington and National League of Cities, et al.

("Oregon").[2] Twenty-two railroads and more than 300 railroad car lines own extensive property and conduct transportation operations in Iowa. Iowa's continued ability to impose any ad valorem tax on railroad transportation property is brought into question by the Ninth Circuit's analysis of Section 306(1)(d). Iowa urges the Court to reverse the Ninth Circuit and hold that Section 306(1)(d) has no application to ad valorem taxes. If the Court finds it necessary to review ad valorem taxes for "discriminatory treatment" under Section 306(1)(d), Iowa requests the Court to adopt a test for discriminatory treatment that does not cast doubt on established principles of unit assessment.

STATEMENT OF THE CASE

Amicus Iowa adopts Petitioner Oregon's statement of the case.

SUMMARY OF ARGUMENT

Section 306(1)(d) of the 4-R Act does not apply to ad valorem taxes because it is limited, by its plain terms, to "other" taxes. Ad valorem taxes are regulated under Sections 306(1)(a) and (c) of the Act. The legislative history confirms that Section 306(1)(d) does not apply to ad valorem taxes.

[2] This amicus brief is submitted on behalf of the State of Iowa by its attorney general. No consent to its filing is required.

The preemptive effects of the comprehensive regulation of ad valorem taxes under Sections 306(1)(a) and (1)(c) of the Act preclude other meaningful tests for "discriminatory treatment" under Section 306(1)(d), affirming that Congress intended Section 306(1)(d) to apply only to taxes other than ad valorem taxes.

ARGUMENT

I. The Plain Language Of Section 306(1)(d) Bars Application To Ad Valorem Taxes.

At issue in this case is the meaning of Section 306(1)(d) of the Railroad Revitalization and Regulatory Reform Act of 1976[3] ("4-R Act"), which prohibits: "[t]he imposition of any other tax which results in discriminatory treatment of a common carrier by railroad . . . " Under Sections 306(1)(a) and (1)(c) of the Act, ad valorem or property taxes are comprehensively and specifically regulated. Since Sections 306(1)(a) and (1)(c) apply to ad valorem taxes, it follows logically from the language of Section 306(1)(d) that "any other tax" refers to any tax *other* than ad valorem taxes. The reference to "other" taxes bars application of Section 306(1)(d) to ad valorem taxes.

[3] Pub. L. No. 92-210, 90 Stat. 54 (Feb. 5, 1976), codified with some changes in language at 49 U.S.C. § 11503. "These changes 'may not be construed as making a substantive change in the laws replaced.' 92 Stat. 1466 § 3(a)." *Burlington N. R. Co. v. Oklahoma Tax Comm'n*, 481 U.S. 454, n. 1 (1987). Further references to the 4-R Act are to Section 306. The text of Section 306 is provided in the Joint Appendix.

A. Excluding Ad Valorem Taxes From The Meaning Of "Other" Taxes Is Warranted By Comprehensive Restrictions On Ad Valorem Taxes Imposed In Sections 306(1)(a) and (1)(c).

Ad valorem taxes on rail transportation property are regulated under Sections 306(1)(a) and (1)(c) of the 4-R Act. Section 306(1)(a) (the "ratio" clause) prohibits ad valorem tax assessment ratio[4] differences between railroad transportation property and a defined comparison class of commercial and industrial property. Section 306(1)(c) (the "rate" clause) prohibits ad valorem tax rate or levy differences between railroad transportation property and a defined class of commercial and industrial property. Section 306(3)(c) defines the comparison class of property for both the ratio and the rate clauses as: "all property, real or personal, other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and

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[4] "Ratio" refers to a relationship of fractions defined by the Act. The first fraction is the assessed value of railroad property divided by the fair market value of railroad property. The second fraction is the assessed value of the Section 306(3)(c) comparison class of property divided by the fair market value of the comparison class. The Act specifies that this second fraction be determined through the "random-sampling method known as a sales assessment ratio study (conducted in accordance with statistical principles applicable to such studies)." Section 306(2)(e). The International Association of Assessing Officers has promulgated a standard with respect to such ratio studies. Gloudemans, et al., *Standard on Ratio Studies* (I.A.A.O., July, 1990).

which is subject to a property tax levy." Significant features of this comparison class are: (1) the combination of real and personal property, (2) the restriction to commercial and industrial property, (3) the excision of agricultural and timber property, and finally, (4) the exclusion of exempt property class by the requirement that the class be "subject to a property tax levy."

During the fifteen years the 4-R Act tax provisions were being considered by Congress, the comparison class used to determine if the states were differentially imposing ad valorem taxes on railroads evolved from a very broad class to a class with limitations crafted to accommodate state taxing interests.[5] In two instances,[6] the comparison class for the rate clause was "any other property" in the taxing district. Had Congress retained this broad comparison class, the effect would have been much the same as applying the general discrimination prohibition of Section 306(1)(d) to ad valorem taxes.[7] However, Congress later restricted the comparison class, demonstrating that the ad valorem tax regulation provisions of Sections 306(1)(a) and (1)(c) are independent of and should not be overridden by Section 306(1)(d). The rate and ratio

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[5] See generally, Laronge, *Property Tax Exemptions Under Section 306 of the 4-R Act*, 26 WILLAMETTE L. R. 635 (1990).

[6] S.B. 927 and S.B. 2289, discussed below.

[7] Compare the Ninth Circuit's holding that any significant exemption voids railroad taxation when Section 306(1)(d) is applied to ad valorem taxes with the testimony (discussed below) of the state witnesses on S.B. 927 and S.B. 2289 that the unlimited comparison class on the rate clause would lead to voiding railroad taxation whenever a state exempted property.

clauses are not, as suggested by the United States,[8] "per se" rules, which may be eclipsed by general discrimination analysis under Section 306(1)(d).

Congress set out a single comparison class in Section 306(3)(c), sanctioning continuation of many forms of traditional ad valorem tax classification which benefitted taxpayers other than railroads.[9] Congress amended the comparison class definition to allow states to favor residential, governmental, charitable, and church property by narrowing the comparison class to commercial and industrial property. Congress also allowed states to exempt agriculture and timber production from ad valorem taxation or apply special valuation rules to these properties by amending the comparison class to remove agricultural land and land used for growing timber. Finally, Congress permitted states to exempt other classes of property from taxation when Congress required that property in the comparison class be "subject to a property tax levy." If

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[8] Brief of the United States as Amicus Curiae, on Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, No. 92-74 (April 1993), p. 7, citing *Ogilvie v. State Board of Equalization*, 657 F.2d 204, at 210 (8th Cir. 1981), cert. den., 454 U.S. 1086 (1981).

[9] In addition, Congress added Section 306(2)(c) to allow the states some tolerance before assessment ratios and tax rates were found to be violative of the Act:

> [N]o relief may be granted under this section unless the ratio of assessed value to true market value, with respect to transportation property, exceeds by at least 5 per centum the ratio of assessed value to true market value, with respect to all other commercial and industrial property in the same assessment jurisdiction.

the comparison class had not been thus restricted to create these safe harbors, favorable treatment or exemptions of any properties would have resulted in violations of the ratio or rate clauses.

When Congress limited the comparison class to commercial and industrial property other than timber and agricultural land, Congress removed much more property from the class than it left in the class.[10] In this context, unless there is a specific statement to the contrary, it is wrong to conclude that Congressional concerns about the scope of state exemptions under the "subject to a property tax levy" restriction were the driving force behind the addition of Section 306(1)(d).

Confirmation that Section 306(1)(d) is exclusive of ad valorem taxes lies in the complexity of defining "discriminatory treatment" for ad valorem taxes already restricted by the comprehensive ratio and rate regulations of the Act.

B. The Plain Meaning Of The Restriction To "Other" Taxes In Section 306(1)(d) Was Intended By Its Sponsors And Understood By Congress.

The references in the legislative history to the Section 306(1)(d) "any other tax" language support applying that

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[10] For example, 1992 Florida results show commercial and industrial real and personal property values aggregated less than $280 billion of more than $740 billion total real and personal property value. *Florida Ad Valorem Valuations & Tax Data December 1992* (Florida Department of Revenue, Division of Ad Valorem, 1992). (Relevant portions appended, together with supporting calculations and graphical summary.)

prohibition only to taxes other than ad valorem taxes. The provision was added as a result of concerns with discriminatory taxes imposed "in-lieu" of ad valorem taxes, such as gross receipts taxes.

The history of the "any other tax" clause starts with S.B. 927, in the 90th Congress. That bill contained analogues to Sections 306(1)(a) and (1)(c). However, the comparison class that S.B. 927 used to measure tax rate discrimination consisted of *any other* property in the taxing district. The implication of this broad comparison class was that railroads would not be taxed because there were significant amounts of exempt property in the comparison class. State tax administrators were very concerned about this potential effect of S.B. 927 and testified in favor of significantly restricting the comparison class to allow for several forms of state tax classification. In addition, some of the testimony and submissions noted that ad valorem taxes were not the only taxes which states imposed on common carriers. During 1969 Senate hearings, *State Tax Discrimination Against Interstate Carrier Property, 1969: Hearing Before the Subcommittee on Surface Transportation of the Senate Committee on Commerce on S.B. 2289*, No. 91-28, (91st Cong., 1st Sess., July 30, 1969), (*"Hearings on S.B. 2289"*), Charles Conlon, Executive Secretary of the National Association of Tax Administrators, submitted testimony and included a lengthy resolution against adoption of S.B. 927 (which was virtually identical to S.B. 2289) from the Western States Association of Tax Administrators Committee on Railroad and Utility Valuation. That resolution noted:

> Still other deviations from pure property taxation are "in-lieu taxes" measured by a fixed

> percent of gross earnings or gross rent earned in the state. Examples include private railroad cars, electric cooperatives, certain rural telephone properties, public utility districts and *even common carrier railroads*. Taxes "in lieu" of property taxes have frequently been enacted because equitable assessment within the confines of the property tax was deemed administratively impossible for special purpose, peculiarly situated properties.

Hearings on S.B. 2289, at 86, 87. Mr. Conlon's testimony also included a letter from D. M. Fisher, Assistant Director (U. & I.), Property Tax Division, Oregon State Tax Commission to Hon. Warren G. Magnuson, Committee Chairman. Mr. Fisher predicted that state legislatures would remove railroads from the ad valorem tax system and impose in-lieu taxes to avoid the onerous features of S.B. 927. Mr. Fisher's letter stated:

> The thing that lurks in the background (and this has been discussed with several important railroad men) is that if S. 927 is enacted there is a genuine possibility that state legislatures will move railroads out of the property tax field and use alternative methods of taxation such as gross revenue tax. The end result then can very realistically be more burdensome on carriers than the present less than perfect property tax system.

Hearings on S.B. 2289, at 76.

Later drafts of Section 306 precursors in the House contained the Section 306(1)(d) "any other tax" clause. Steven Ailes, President of the Association of American Railroads testified at the 1975 hearings on H.R. 6351 and

H.R. 7681 and noted that those bills contained prohibitions against "any other tax which results in discriminatory treatment of a railroad." *Railroad Revitalization: Hearings Before the Subcommittee on Transportation and Commerce of the Committee on Interstate and Foreign Commerce, House of Representatives on H.R. 6351 and H.R. 7681*, No. 94-38 (94th Cong., 1st. Sess., July 15, 16, 17, 22, and 24, 1975), at p. 570.

However, Senate drafts of similar legislation before the 94th Congress omitted the "any other tax" clause. After the House hearings, Mr. Ailes appeared at Senate hearings and suggested adding the "any other tax" language to Senate drafts. Mr. Ailes stated: "We suggest that the bill should be amended by adding a fourth prohibition, namely, *one against taxes that are in-lieu of discriminatory property taxes that are covered by the first three prohibitions* listed above." (Emphasis added.) *Hearings Before the Subcommittee on Surface Transportation of the Senate Commerce Committee on Legislation Relating to Rail Passenger Service*, No. 94-31, Part 5, at 1837. (94th Cong., 1st Sess., October 20, 21, & 30, 1975).

Mr. Ailes' testimony before the Senate was supported by Stuart H. Johnson, Jr., counsel for the New York Dock Railway. Mr. Johnson suggested that the Senate insert the "any other tax" provision to relieve the New York Dock railroad from the burden of New York City's gross receipts tax – an in-lieu tax. *Hearings* at 1885, 1886. Subsequent Senate drafts of the 4-R Act tax provisions included the "any other tax" clause.

The only Congressional explanations of the "any other tax" provision refer to restrictions on "in-lieu tax."

See, e.g. the 1976 Conference Committee Report, *Railroad Revitalization and Regulatory Reform Act of 1976: Report of the Committee of Conference on S. 2718*, Report No. 94-595 (94th Cong., 2d Sess., Jan. 27, 1976), p. 166, where the H.R. 10979 language is referred to as prohibiting "imposition of a discriminatory 'in-lieu tax.' "[11]

II. Sections 306(1)(a) and 306(1)(c) Preempt Section 306(1)(d) Analysis Of Ad Valorem Tax "Discriminatory Treatment" By Reference To Disparate Impact.

A. The Ninth Circuit Decision Illustrates That Disparate Impact Cannot Be The Measure Of "Discriminatory Treatment".

Assuming, for the sake of argument, that ad valorem taxes may be reviewed under Section 306(1)(d), raises the question of what constitutes the prohibited "discriminatory treatment" in ad valorem taxes. If no satisfactory test for "discriminatory treatment" exists, then Section 306(1)(d) should not be applied to ad valorem taxes.

One possible test for discriminatory treatment would be to determine whether the subject tax system differentially affects railroads. The Ninth Circuit below applied this type of disparate impact analysis and voided Oregon's tax on car lines.[12] In contrast to the clear command

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[11] The Seventh Circuit has held that the "any other tax" clause cannot be confined to "in-lieu" taxes, *Burlington N. R. Co. v. City of Superior, Wisconsin*, 932 F.2d 1185 (7th Cir. 1991). However, the result with respect to ad valorem taxes should be different because of the specific limitation to "other" taxes.

[12] Oregon's tax exemptions did not facially discriminate against railroads and the Ninth Circuit's *de minimis* analysis

of the Act to limit the comparison class to taxable property, the Ninth Circuit struck down Oregon's ad valorem tax on car lines because Oregon exempted, inter alia, merchants' inventories.[13] In doing so, the Ninth Circuit wrongly nullified an amendatory limitation on the Section 306(3)(c) comparison class worked out by Congress and reflected in the legislative history of the comparison class language provisions. The Ninth Circuit's decision is illustrative of the legal quagmire created by judicial attempts to fabricate a disparate impact test from the generic anti-discrimination provisions of Section 306(1)(d) when all meaningful disparate impact choices have been made by Congress under Sections 306(1)(a) and (1)(c). The next two sections explain the significance, history and timing of the Section 306(3)(c) limitation on the comparison class to property "subject to a property tax levy" that the Ninth Circuit voided and demonstrate why that limitation should be honored even if the Court applies Section 306(1)(d) to ad valorem taxes.

1. The "subject to a property tax levy" limitation on the commercial and industrial comparison class was inserted to permit states to exempt any class and category of property from ad valorem taxes without 4-R Act consequences.

Section 306(1)(a) prohibits:

> The assessment (but only to the extent of any portion based on excessive values . . .),

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shows that the court was not dealing with an implied evasion problem.

[13] The Ninth Circuit's *de minimis* analysis indicates that the court would have stricken Oregon's tax on car lines for the merchants' inventory exemption alone.

> . . . of a property tax . . . [on] transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial and industrial property . . . bears to the true market value of all such other commercial and industrial property.

The comparison class of "commercial and industrial property" is defined in Section 306(3)(c) of the Act as: "all property, real or personal, other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and which is subject to a property tax levy."

The final phrase of the definition: "subject to a property tax levy," has a legislative history which refutes the Ninth Circuit's analysis of Section 306(1)(d). The history of the "subject to a property tax levy" clause covers the entire fifteen year span of consideration of the tax provisions of the 4-R Act, beginning with the *Doyle Report* in 1961, including extensive testimony and revisions to S.B. 2289 in 1969 and 1970, through final acceptance by Conference Committee in 1976 as an inclusion in Section 306(3)(c) of the Act.

a. The Doyle Report. The 4-R Act tax provisions had their genesis in the 1961 Report *National Transportation Policy, Report of the Committee on Commerce, United States Senate by its Special Study Group on Transportation Policies in the United States*, Report No. 87-445 (87th Cong., 1st Sess., June 26th, 1961), ("*Doyle Report*"). The *Doyle Report* suggested two alternative remedies to state tax discrimination against rail transportation property. The first was to exempt rail property from ad valorem

taxes. The second remedy was proposed by the Association of American Railroads ("AAR") and contained the first drafts of the ratio and collection restrictions which were later incorporated in Sections 306(1)(a) and 306(1)(b). The commentary in the report states that no substantive change of state tax laws was intended, but rather, federal enforcement and remedies were being added to existing state uniformity requirements:

> This proposed anti-discrimination tax bill . . . has the obvious merit of insuring that such carriers would receive equal treatment with other taxpayers subject to the same tax rates in accordance with applicable State law. The proposal in no way alters the freedom of the State to tax its taxpayers as in its discretion it deems best, so long as such carriers are accorded equal tax treatment with other taxpayers.
>
> Passage by the Congress of such a bill would not change the substantive effect of the tax laws of the several States because, without exception, all States, either by constitutional safeguard or legislative provision declare it to be State law that taxpayers within its jurisdiction shall be taxed uniformly. The addition of a procedural remedy . . . is consistent with the obligation of Congress to regulate interstate commerce.

Doyle Report, at p. 466.

While discriminatory state tax practices were critiqued in the *Doyle Report*, state tax exemptions were not suggested to be a source of the discrimination. The committee reference to state uniformity clauses is telling, because only one state supreme court has gone so far as to hold ordinary exemptions to be violative of state uniformity requirements, and then only recently. *Northern*

Nat'l Gas Co. v. State Bd. of Equalization & Assessment, 232 Neb. 806, 443 N.W.2d 249 (1989), cert. den. sub nom., *State Bd. of Equalization & Assessment v. Northern Nat'l Gas Co.*, 493 U. S. 1078 (1990).

b. S.B. 2289. In 1969, S.B. 2289, another precursor to Section 306, was introduced in Congress. This bill also contained early versions of Sections 306(1)(a) and 306(1)(c) and, in addition, defined a comparison class of "any other property in the taxing district." However, the committee report contradicted the plain language of the bill, stating that wholly or partially exempt property was not intended to be part of the comparison class.

> "[A]ny other property in the taxing district" is not intended to interfere or restrict state action in extending total or partial exemption to property of a class such as churches, charitable institutions, homesteads and the like. *In other words, property totally or partially exempted is not intended to be taken as a measure of "any other property" for tax rate purposes.* (Emphasis added.)

Discriminatory State Taxation Of Interstate Carriers: Report of the Senate Committee on Commerce to Accompany S. 2289, Report 91-630, p. 11 (91st Cong., 1st Sess., December 20, 1969). The conflict between the express provisions of S.B. 927 (virtually identical to S.B. 2289) and the similar Committee Report on that bill provoked pivotal testimony at the 1969 Senate Hearings on S.B. 2289.

Charles Conlon, Executive Secretary of the National Association of Tax Administrators, testified on behalf of 27 subscribing states and submitted a supplemental resolution on behalf of the Western States Association of Tax Administrators ("WSATA") Committee on Railroad and Utility Valuation.

One of Mr. Conlon's themes was that S.B. 2289 was an unjustified restriction on the states' ability to classify property for tax purposes. Mr. Conlon described state policy supporting "incentives for better land use, to encourage location of industry, for homestead tax relief and for old-age property tax relief" as having merit which should prevail over railroad tax concerns. *Hearings on S.B. 2289*, at p. 70.

The resolution from the WSATA Committee on Railroad and Utility Valuation criticized S.B. 927 (which was similar to S.B. 2289) for interfering with state prerogatives in classifying property for taxation, specifically including restrictions on exemptions. The resolution stated:

> Basic to the whole problem, possibly is the question of whether the states have a right to classify property as to the different shares of the cost [of] government that different classes of property may legally be required to carry. Extreme examples are the exemption of certain properties from taxation. These exemptions may be for social, economic, or administrative reasons and include examples such as: . . . manufacturing plants under construction; industrial plants; personal property; . . . goods in process of manufacture . . .

Hearings on S.B. 2289, at p. 86.

Mr. Conlon's testimony was specifically subscribed by Washington State and amplified by a submission including proposed amendments from George Kinnear, Director of the Washington Department of Revenue. Mr. Kinnear stated:

Next let us consider the implications of using "all other property in the taxing district" as the basis for comparing carrier property assessments with other assessments.

The bill offers carriers a chance and opportunity to claim entitlement to lower tax assessment by reason of State or local policy decisions which are completely unrelated to any deliberate discrimination against common carriers.

I will give you some examples of sound policies which would create this unfair and improper result. First, a number of states have adopted so-called "Green-belt" legislation which provides for lower taxation for certain types of property. . . . For example some States have reduced the tax burden on inventories by various methods – for instance, by assessing them on 50% of full value instead of 100% – and this is done as a policy based on what are considered to be economic facts.

Hearings on S.B. 2289, at p. 101.

In 1970 House hearings on S.B. 2289 and H.R. 16245, Charles H. Otterman, Chief Counsel for the California Board of Equalization, submitted testimony on the issue of the conflict between the proposed statutory language of S.B. 2289 and the Committee Report conclusion that exempt property was not a part of the comparison class. Mr. Otterman cited as one particular concern that: "We have a 50-percent exemption for business inventories, and we have other things that I won't mention in detail, but all these things are done for policy reasons aside from discrimination against railroads." *Common and Contract Carrier State Property Tax Discrimination, 1970: Hearing Before the Subcomm. on Transportation and Aeronautics of the House Comm. on Interstate and Foreign Commerce on H.R.*

16245, H.R. 16251, H.R. 16316, H.R. 16357, H.R. 16411, H.R. 16639 and S.B. 2289, No. 91-61 (91st Cong., 2d Sess., June 9, 1970), p. 90 (*"Hearings on H.R. 16245"*).

At the same hearings, the Advisory Committee on Intergovernmental Relations submitted a letter from its acting Executive Director, David Walker, in support of state authority to classify property for ad valorem tax purposes. Mr. Walker stated:

> Certain types of personal property (e.g., merchant's inventories) may be assessed at a different percentage of value than other real and personal property, as in Florida. . . . As long as these differential tax burdens are hammered out in the open legislative arena – and not "negotiated" behind the closed door of the assessor's office – only the requirements of due process are needed as a safeguard against any arbitrary and unreasonable legislative classification.

Hearings on H.R. 16245, at p. 2

In order to cure the perceived problems with the overly broad comparison class, Mr. Conlon suggested comparison class language which would permit states to exempt property:

> Explanatory comments in committee reports are extremely useful. However, they are in no sense a substitute for precise draft[s]manship in the first instance. If the bill means what appendix C says it means, why not say so in the bill?
>
> For example, if the intended standard of comparison is the general average assessment ratio, the language of the bill might refer to:
>
> > . . . the assessment . . . of transportation property . . . on the basis of an assessment ratio which is higher than the general average assessment ratio prevailing in the assessment district for property *subject to a property tax levy*. . . .

Or preferably:

> . . . on the basis of an assessment ratio which is higher tha[n] the general average assessment ratio prevailing in the assessment district for comparable property *subject to a property tax levy*. . . .

The second alternative insures that where carrier property is included along with other types of business property in a separate classification for assessment purposes, the standard of comparison will be the assessment ratio prevailing in the assessment district for business property.

The references to tax rates may be similarly clarified by stating the standard as follows:

> . . . at a tax rate higher than the tax rate generally applicable to *taxable property* in the taxing district. . . .
>
> Or, again, preferably:
>
> > . . . at a tax rate higher than the generally applicable tax rate for comparable property in the taxing district. (Emphasis added.)

Hearings on S.B. 2289, at pp. 80, 81. Mr. Conlon's language appears, without change, in the comparison class definition of Section 306(3)(c).

Mr. Conlon was not alone. Mr. Kinnear also offered up his solution in almost identical language:

> While I have been severely critical of S. 2289, as presently written, I feel a responsibility

to be constructive, rather than purely negative . . . I would not, as Director of the Department, oppose enactment of Federal legislation with the declared objective of S. 2289, if such legislation involved the following amendments: . . .

> (a) the assessment . . . of transportation property . . . at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of non-transportation property in the assessment jurisdiction *subject to property tax levies* bears to the true market value of all such other property. (Emphasis added.)

Hearings on S.B. 2289, at p. 102. Mr. Kinnear also suggested limiting the tax rate comparison class to "taxable" property. *Hearings on S.B. 2289*, at p. 102.

Mr. Otterman suggested language restricting the comparison class to commercial "taxable property." *Hearings on H.R. 16245*, at p. 94. "Taxable property" is used at the end of Section 306(2)(e) synonymously with "subject to a property tax levy."

Messrs. Otterman, Kinnear, Conlon and Walker, along with numerous other witnesses, suggested that exemptions for merchants' inventories (and a wide variety of other properties typically or atypically exempted from tax) were state policy choices that ought to be protected from 4-R Act scrutiny. Mr. Conlon's language limiting the comparison class to property – "subject to a property tax levy" – appears without change in Section 306(3)(c). In adopting this language, Congress clearly permitted states to exempt any class and category of property without violating the 4-R Act.

The testimony from both Mr. Kinnear and Mr. Conlon goes even further. Their focus on taxable properties in the comparison class and the general or overall assessment of such properties shows that they intended every kind of exemption to be permissible. They were not concerned with what was removed from the tax base or how it was removed. The difficulties of determining assessment ratios for properties which were exempt, particularly for unreported items of personal property, would have been well known to Mr. Conlon and Mr. Kinnear. Mr. Conlon and Mr. Kinnear were also undoubtedly aware that no state had exempted (or is ever likely to exempt) a sufficient amount of all commercial and industrial real and personal property as to implicate the validity of the ratios on the remaining property.[14] Accordingly, the classification of exempt property and whether or not it could be characterized as discriminatory, did not confine Mr. Kinnear's and Mr. Conlon's intent in their submissions. All exempt property, particularly personal property, was intentionally removed from the comparison class.[15]

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[14] Congress did provide for this unlikely event, however, when it set out an alternate comparison class of all taxable property in Section 306(2)(e).

[15] This review of the legislative history of the phrase "subject to a property tax levy" also refutes one of the principal arguments that the railroads and car lines have made to limit the scope of the "subject to a property tax levy" language. The railroads and car lines have argued that the limitation to taxable property was inserted solely to preserve the traditional state exemptions of governmental, charitable, and religious property. The language of the limitation on the comparison class does not support this interpretation and the Congressional history conclusively discredits any narrow interpretation of the limitation language.

Further support for the proposition that Congress adopted Messrs. Otterman's, Conlon's and Kinnear's intent in modifying the comparison class definition is provided by reviewing the other amendments to the Act which were suggested by these influential witnesses and accepted by Congress. Mr. Kinnear proposed that S.B. 2289 be amended to exclude agricultural land and timber land from the comparison class, to give the states a 5% threshold on ratio discrimination, and to refine the definitions of taxing districts and transportation property. Congress incorporated all these amendments in the 4-R Act. Mr. Kinnear's influence on the process of developing the 4-R Act was acknowledged by James A. Washington, Jr., General Counsel for the United States Department of Transportation. *Hearings on H.R. 16245*, at pp. 6, 7. Mr. Otterman testified in favor of restricting the comparison class to commercial property. Congress also adopted this limitation on the comparison class.[16]

In view of the language of the Act and the legislative history, it is clear that the dicta from *Ogilvie v. State Board of Equalization*, 657 F.2d 204, at 210 (8th Cir. 1981), cert. den., 454 U.S. 1086 (1981), that Section 306(1)(d) was inserted into the Act "to prevent tax discrimination . . . in any form whatsoever," is erroneous. No such statement about Section 306(1)(d) appears in the legislative history. The Eighth Circuit's statement is inconsistent with the actual language of the clause, which contains a limitation to "other" taxes. Review of the *Ogilvie* decision reveals

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[16] For further exposition of these points, see Laronge, *Property Tax Exemptions Under Section 306 of the 4-R Act*, 26 Willamette L. R. 635 (1990).

that the statement is based on the Eighth Circuit's incomplete assessment of the legislative history.[17] Examination of ad valorem taxes under Section 306(1)(d) would negate a host of carefully wrought compromises in the comparison class definition, such as the limitation to commercial and industrial property, the exclusion of agricultural and timber land, and most significantly, the limitation to taxable property, which was accepted by Congress after Section 306(1)(d).[18]

2. The "subject to a property tax levy" limitation on the comparison class is not overridden by Section 306(1)(d).

Another persistent argument made by the railroads and the car lines and accepted by the Ninth Circuit below is that Section 306(1)(d) is an overriding afterthought which should be read to negate the comparison class restrictions, particularly the "subject to a property tax" limitation, in Section 306(3)(c). However, the premise of this argument is not consistent with the actual history of the Act. Congress inserted the "subject to a property tax levy" language into the comparison class definition *after* Section 306(1)(d) was a settled part of the Act.

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[17] See, Laronge, *Property Tax Exemptions Under Section 306 of the 4-R Act*, 26 Willamette L. R. 635, nn. 69, 76 (1990).

[18] Section 306(1)(d) does not contain a reference to the Section 306(3)(c) comparison class of commercial and industrial property. The import of this omission is not that the courts are free to create another comparison class of property when considering 306(1)(d) claims against ad valorem taxes, but rather that Section 306(1)(d) does not apply to ad valorem taxes at all.

The 4-R Act resulted from Senate passage of S.B. 2718 and House passage of H.R. 10979, reconfigured as an amendment to S.B. 2718. The differences between H.R. 10979 and S.B. 2718 were resolved by Conference Committee. One significant difference between H.R. 10979 and S.B. 2718 was that the H.R. 10979 comparison class was not limited to property "subject to a property tax levy."[19] The Conference Committee accepted the Senate limitation of the Section 306(3)(c) comparison class of commercial and industrial property to taxable property.[20] This had the effect of ensuring that the comparison class limitation to taxable property applied to both Sections 306(1)(a) and (1)(c). Section 306(1)(d) was already a feature of both H.R.

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[19] Compare § 207(c)(3) of S.B. 2718 (text appended) with § 601(2)(c) of H.R. 10979 (text appended). H.R. 10979, § 601(1)(a) (analogous to the § 306(1)(a) rate clause) contained a separate limitation on the comparison class which excluded exempt property. This limitation was not included in the definition of the comparison class and did not apply to § 601(1)(c) (analogous to the § 306(1)(c) rate clause). This same pattern appeared in S.B. 927 and S.B. 2289. The discrepancy in the comparison class definitions created the doubts about the scope of relief being afforded to railroads reflected in the testimony of Messrs. Kinnear, Conlon, Walker, Otterman, et al., cited above.

[20] See *Railroad Revitalization and Regulatory Reform Act of 1976: Report of the Committee of Conference on S. 2718*, Report No. 94-595 (94th Cong., 2d Sess., Jan. 27, 1976), at 166. ("The conference substitute follows the Senate bill" except for the so-called "Tennessee Amendment".).

10979 and S.B. 2718[21] and thus did not require a choice by the conference committee.[22]

With all the choices that Congress made on the operation of Sections 306(1)(a) and (1)(c), including the significant restrictions on the comparison class, the use of ratio studies to test for differential tax assessment ratios, and the 5% threshold, it makes no sense to apply any separate differential or disparate impact analysis under Section 306(1)(d).

III. Facial Discrimination Tests Cannot Be Satisfactorily Applied To Ad Valorem Taxes.

Rejecting disparate impact as a test for discrimination under Section 306(1)(d) is called for because of preemption reflected in the plain language of the Act. Other widely accepted tests for discrimination present problems of similar difficulty.

Facial discrimination is another potential test which may be evaluated. However, facial discrimination tests

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[21] Compare § 207(a)(4) of S.B. 2718 with § 601(1)(d) of H.R. 10979.

[22] S.B. 2718 also contained a provision which would have allowed states to continue discriminatory practices if incorporated in state constitutions. This provision was known as the "Tennessee Amendment." House objections to this provision prevailed in Conference Committee. In the retention of the Senate's limitation of the comparison class to property subject to a property tax levy and the rejection of the Senate's "Tennessee Amendment," the House and the Senate appear to have swapped horses.

are susceptible to misuse, may void existing and established taxing methodologies and add no meaningful protections to those already provided to railroads under Sections 306(1)(a) and (1)(c).

A. Facial Discrimination Tests Have Been Rejected By The Seventh And Eleventh Circuits.

Two Circuits have rejected facial discrimination analysis under Section 306(1)(d). See, *Dep't of Revenue, State of Florida v. Trailer Train Co.*, 830 F.2d 1567 (11th Cir. 1987), (rejecting constitutional discrimination analysis) and *Burlington N. R. Co. v. City of Superior, Wisconsin*, 932 F.2d 1185 (7th Cir., 1991) (reversing trial court application of a facial discrimination test.)

B. Facial Discrimination Analysis Will Invalidate Taxes Where There Is No Disparate Impact.

Since railroads are already protected by a comprehensive scheme of ad valorem tax disparate impact restrictions, applying an additional facial discrimination analysis to ad valorem taxes would create a host of problems. The railroads may use a facial discrimination analysis to attack allowable state tax policy choices embedded in the comparison class definition. For example, railroad car lines might argue that inventory exemptions or industry location exemptions should void railroad car line taxation because such exemptions are merely disguised facial discrimination, since it is well known that car lines have no inventory and are already located in every taxing state. These arguments would bring into question state

exemptions expressly permissible under the limitation of the comparison class to taxable property.

Even if the Court enunciates a facial discrimination test that protects allowable disparate impacts on railroads, this still leaves the possibility that railroads will attack state tax classification schemes that cause no differential impact. However, there is no indication in the language of the Act or the Congressional history that separate classification not leading directly or indirectly to disparate tax impact was of any concern to the railroads or Congress. In addition, facial discrimination tests, which do not measure the impact of the discrimination, lead to an all or nothing remedy. Any separate classification of railroads for taxation, such as is common in apportionment formulae or unit-rule assessment statutes, could lead to wholesale voiding of state railroad taxation. There would be no rational way to excise only the discriminatory portion of such classifications without engaging in preempted disparate impact analysis.

C. Facial Discrimination Tests Implicate Unit Rule Assessment.

Discrimination tests which invalidate tax systems for different facial classifications of railroads bring into question the validity of unit assessment of railroads. A majority of states classify railroad and public utility property for unit-rule assessment, relying on *State Railroad Tax Cases*, 92 U.S. 575 (1875) and *Adams Express v. Ohio State Auditor*, 165 U.S. 194 (1897), reh. den., 166 U.S. 185 (1897). Unit-rule assessment is an ad valorem tax determination which focuses on the valuation of the entire operating

unit of a subject company. The unit valuation is then fairly apportioned to the taxing state and the taxing state's apportioned value further allocated among the taxing districts within the state. Unit-rule assessment contrasts with typical assessment procedures that focus on valuation of individual parcels of real and personal property.

The Eighth Circuit's analysis in *Burlington N. R. Co. v. Bair*, 766 F.2d 1222 (8th Cir. 1985), indicates that classification of railroads with other utility property is an insufficiently broad group to sustain the classification against a charge of facial discrimination. If this precedent is not disapproved, facial discrimination analysis may void unit-rule assessment, since classification of railroads and utilities is a feature of all unit-rule assessment statutes. A trial court in Iowa has already found inherent discrimination between unit-rule assessment of railroad property and local assessment of commercial and industrial property, which resulted from unit-rule assessment's intrinsic capture of "intangible" values.[23] While Congress may have the legislative authority to preempt unit-rule assessment, more than a misinterpretation of the thin history of Section 306(1)(d) should be required before the Court upsets such an accepted, universal system of taxation.

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[23] See *Burlington N. R. Co. v. Bair*, 4:90-CV 60406, U.S. Dist. Ct., S. Dist. of Iowa, Central Division, Ruling & Order (March, 1993), relevant portion appended (calculation of relief modified on motion for clarification).

IV. Case By Case Analysis Of Discrimination Should Not Be Applied To Ad Valorem Taxes.

Another possible approach to applying Section 306(1)(d) to ad valorem taxes would be to leave to the lower courts discretion to decide case by case whether each state tax system discriminated. However, if the Court does not tie the determination of discrimination to a fixed comparison class or limit the finding of discrimination by requiring some other threshold, such as facial discrimination or intent, Section 306(1)(d) becomes unenforceably vague and subject to constitutional attack. *United States v. L. Cohen Grocery Co.*, 255 U.S. 81 (1921) (striking statute which prohibited "unreasonable" rate or charge for necessities); *Soglin v. Kauffman*, 418 F.2d 163 (7th Cir. 1969) (striking University of Wisconsin suspension of students for "misconduct."). Case by case analysis means that different conclusions will be drawn in different courts and there will be no predictability about what tax systems will be invalidated.

The Ninth Circuit's decision below illustrates the mischief that can result from handcrafted comparison classes. The Ninth Circuit rejected the Section 306(3)(c) comparison class as a reference point for its discrimination analysis because Section 306(1)(d) does not refer directly to the comparison class. The Ninth Circuit then constructed another comparison class which *included* exempt property but honored the other exclusions from the comparison class such as agricultural land, governmental property, etc. With no statutory basis for chosing which comparison class limitations to honor, the Ninth Circuit's selective inclusion of exempt property cannot be justified. Standardless selection of the comparison class

elements used as a reference point for discrimination analysis of ad valorem taxes will lead to arbitrary choices of which tax systems to void. The Court should not leave the lower courts to unrestricted case by case determinations of discrimination.

Since there is no satisfactory way to apply the Section 306(1)(d) discrimination prohibition to ad valorem taxes, the Court should follow the plain language of the Act and restrict Section 306(1)(d) to taxes other than ad valorem taxes.

CONCLUSION

The Court should reverse the Ninth Circuit and hold that Section 306(1)(d) of the 4-R Act does not apply to ad valorem taxes.

Respectfully submitted

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State of Iowa

Florida Ad Valorem Valuations & Tax Data December 1992
(Florida Department of Revenue, Division of Ad Valorem, 1992

TABLE 2 COMPARATIVE STATEMENT OF 1992, 1991, 1990 AND 1989 TAX ROLLS
JUST VALUES - PERSONAL PROPERTY ONLY
1992 VALUE
TOTALS: 78,377,229,503

TABLE 22 COMPARATIVE STATEMENT OF 1992, 1991, 1990 AND 1989 TAX ROLLS
INSTITUTIONAL EXEMPT VALUE - PERSONAL PROPERTY ONLY
1992 VALUE
TOTALS: 2,134,847,012

TABLE 23 COMPARATIVE STATEMENT OF 1992, 1991, 1990 AND 1989 TAX ROLLS
GOVERNMENT EXEMPT VALUES - PERSONAL PROPERTY ONLY
1992 VALUE
TOTALS: 15,633,699,273

1992 JUST VALUE OF REAL PROPERTY BY CATEGORY

	RESIDENTAL		MOBLE	MULTI FAMILY	
	VACANT	SGL FMLY	HOMES	10 UNITS	9 UNITS
TOTALS:	26,762,470,621	226,633,552,486	9,333,473,446	11,792,808,957	16,949,715,443

1992 JUST VALUE OF REAL PROPERTY BY CATEGORY - CONT'D

	CONDOMINIA	COOPERATIVES
TOTALS:	74,409,607,031	2,834,039,813

1992 JUST VALUE OF REAL PROPERTY BY CATEGORY - CONT'D

	RETIREMENT HOMES	VACANT COMMERCIAL	IMPROVED COMMERCIAL	VACANT INDUSTRIAL
TOTALS:	1,821,400,780	8,263,905,578	78,726,589,462	2,792,195,181

1992 JUST VALUE OF REAL PROPERTY BY CATEGORY - CONT'D

	IMPROVED INDUSTRIAL	AGRICULTURAL
TOTALS:	18,356,330,600	35,461,713,296

App. 2

1992 JUST VALUE OF REAL PROPERTY BY CATEGORY - CONT'D

	INSTITUTIONAL	GOVERNMENT	LEASEHOLD	MISCELLANEOUS
TOTALS:	15,215,857,929	51,976,652,917	1,034,809,218	4,968,357,123

1992 JUST VALUE OF REAL PROPERTY BE CATEGORY - CONT'D

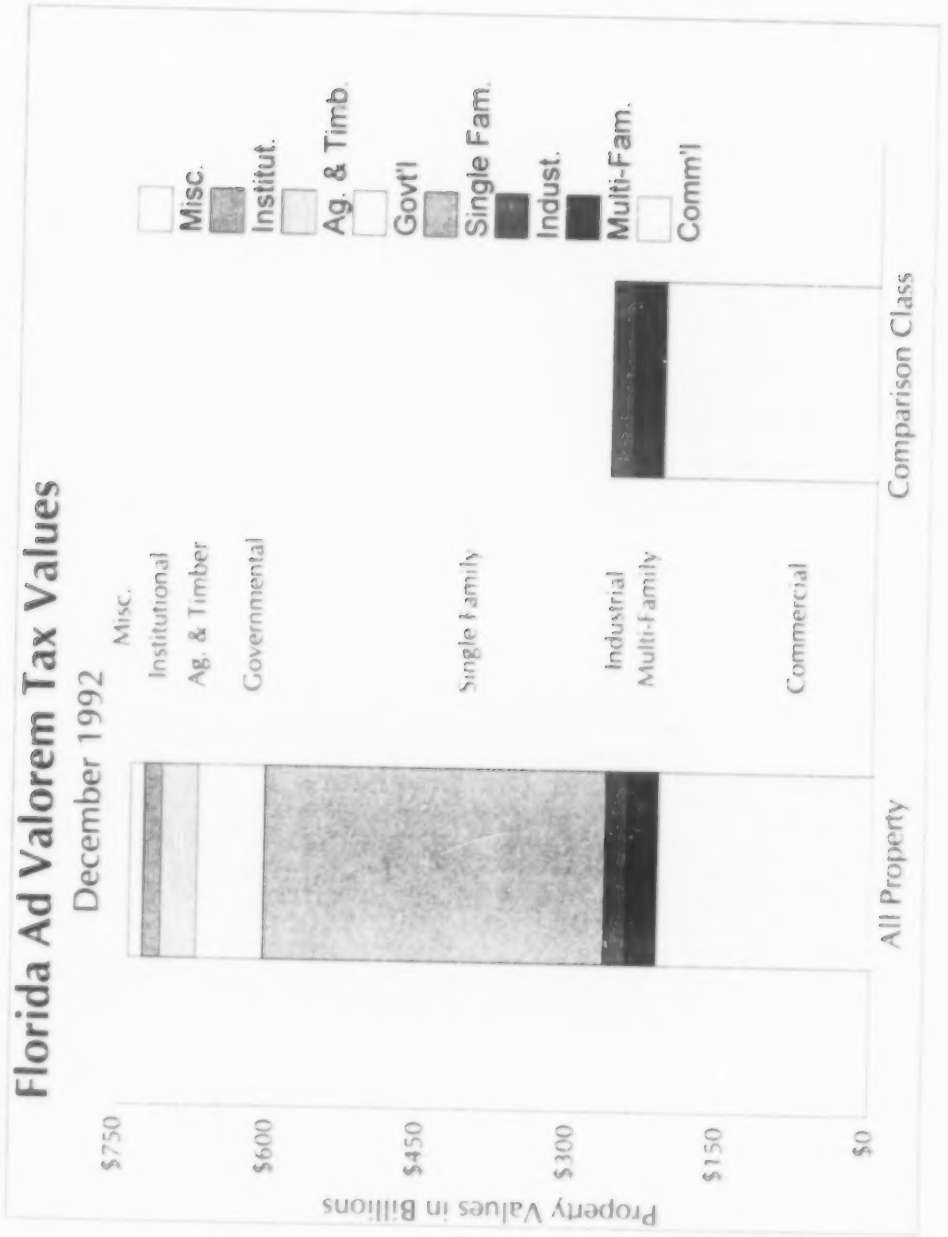
	NON - AG	TOTALS
TOTALS:	6,885,293,447	594,292,292,052

App. 3

Florida Ad Valorem Valuations and Tax Data
December, 1992

	All Property in $ billions	§ 306(1)(d) Comm'l & Ind. (w/o exemptions)	
Real Property			
Multi-Family Resid.	28.7	28.7	
Retirement Homes	1.8	1.8	
Vac. Commercial	8.3	8.3	
Commercial	78.7	78.7	
Vacant Industrial	2.8	2.8	
Industrial	18.4	18.4	
Governmental	$52.0	N/A	
Institutional	15.2	N/A	
Residential			
Vacant	26.7	N/A	
Single Family	226.6	N/A	
Mobile Homes	9.3	N/A	
Condominia	74.4	N/A	
Cooperative	2.8	N/A	
Agric. (incl. Timb.)	35.5	N/A	
Misc.	5.0	N/A	
Non-Ag.	6.9	N/A	
Leasehold	1.0	N/A	
Subtotal: Real	$594.1		$138.7
Personal Property			
Taxable Tang.	$78.4	$78.4	
Inventory *	50.0	50.0	
Governmental	15.6	N/A	
Institutional	2.1	N/A	
Subtotal: Personal	$146.1		$128.4
Total Real & Personal	$740.2		$267.1

* Inventory estimated from 1982 data developed by experts engaged on remand of Trailer Train v. Dep't of Rev., State of Florida, 830 F.2d 1567 (11th Cir. 1987) Trailer Train's expert estimated $21.2 billion. Florida D.O.R.'s expert estimated $16.3 billion. The $50 billion is based on the higher figure and includes growth from 1982 to 1992.



S. 2289

That the Interstate Commerce Act, as amended, is amended by inserting after section 25 thereof a new section 25a as follows:

"Sec. 25a. (1) Notwithstanding the provisions of section 202(b), the following action by any State, or subdivision or agency thereof, whether such action be taken pursuant to a constitutional provision, statute, or administrative order or practice, or otherwise, is hereby declared to constitute an unreasonable and unjust discrimination against and an undue burden upon interstate commerce and is hereby forbidden and declared to be unlawful: (a) the assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property owned or used by any common or contract carrier subject to economic regulation pursuant to the provisions of the Interstate Commerce Act at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other property in the taxing district subject to a prope :y tax levy bears to the true market value of all such other property; (b) the collection of any tax on the portion of said assessment so declared to be unlawful: or (c) the collection of any ad valorem property tax on such transportation property at a tax rate higher than rates applicable to any other property in the taxing district.

"(2) Notwithstanding the provisions of section 1341, title 28, United States Code, or of the constitution or laws of any State, the district courts of the United States shall

have jurisdiction, upon complaint and after hearing, to issue such writs of injunction or other proper process, mandatory or otherwise, as may be necessary to restrain any State, or subdivision or agency thereof, or any person from doing anything or performing any act declared by paragraph (1) hereof to be unlawful: *Provided, however,* That such jurisdiction shall not be exclusive of that which any Federal or State court may otherwise have: *And provided further,* That the provisions of this paragraph (2) shall not become effective until three years after the date of enactment."

S. 2718

Sec. 207. Part I of the Interstate Commerce Act is amended by redesignating section 27 thereof as section 28 thereof and by inserting after section 26 thereof a new section 27, as follows:

"Sec. 27. (a) Notwithstanding the provisions of section 202(b), any action described in this subsection is declared to constitute an unreasonable and unjust discrimination against, and an undue burden on, interstate commerce. It is unlawful for a State, a political subdivision of a State, or a governmental entity or person acting on behalf of such State or subdivision to commit any of the following prohibited acts: "(1) The assessment (but only to the extent of any portion based on excessive values as hereinafter described), for purposes of a property tax levied by any taxing district, of transportation property at a value which bears a higher ratio to the true market value of such transportation property than the ratio which the assessed value of all other commercial

and industrial property in the same assessment jurisdiction bears to the true market value of all such other commercial and industrial property.

"(2) The levy or collection of any tax on an assessment which is unlawful under paragraph (1).

"(3) The levy or collection of any ad valorem property tax on transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the same assessment jurisdiction.

"(4) The imposition of any other tax which results in discriminatory treatment of a common or contract carrier subject to this part I, part II, part III, or part IV of this Act.

"(b) Notwithstanding any provision of section 1341 of title 28, United States Code, or of the constitution or laws of any State, the district courts of the United States shall have jurisdiction, without regard to amount in controversy or citizenship of the parties, to grant such mandatory or prohibitive injunctive relief, interim equitable relief, and declaratory judgments as may be necessary to prevent, restrain, or terminate any acts in violation of this section, except that (1) such jurisdiction shall not be exclusive of the jurisdiction which any Federal or State court may have in the absence of this subsection; (2) the provisions of this section shall not become effective until 3 years after the date of enactment of this section; (3) no relief may be granted under this section unless the ratio of assessed value to true market value, with respect to transportation property, exceeds by at least 5 percent the ratio assessed value to true market value, with respect to

all other commercial and industrial property in the same assessment jurisdiction; (4) the burden of proof with respect to the determination of assessed value and true market value shall be that declared by the applicable State law; and (5) in the event that the ratio of the assessed value of all other commercial and industrial property in the assessment jurisdiction to the true market value of all such other commercial and industrial property cannot be established through the random-sampling method known as a sales assessment ratio study, conducted in accordance with statistical principles applicable to such studies, to the satisfaction of the court hearing the complaint that transportation property has been or is being assessed or taxed in contravention of the provisions of this section, then the court shall hold unlawful an assessment of such transportation property at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other property in the assessment jurisdiction in which is included such taxing district and subject to a property tax levy bears to the true market value of all such other property, and the collection of any ad valorem property tax on such transportation property at a tax rate higher than the tax rate generally applicable to taxable property in the taxing district.

"(c) As used in this section, the term –

"(1) 'assessment' means valuation for purposes of a property tax levied by any taxing district;

"(2) 'assessment jurisdiction' means a geographical area, such as a State or a county, city, township, or special purpose district within such State which is a

unit for purposes of determining the assessed value of property for ad valorem taxation;

"(3) 'commercial and industrial property' or 'all other commercial and industrial property' means all property, real or personal other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber, which is devoted to a commercial or industrial use and which is subject to a property tax levy; and

"(4) 'transportation property' means transportation property, as defined in regulations of the Commission, which is owned or used by a common or contract carrier subject to economic regulation under part I, II, III, or IV of this Act, or which is owned by the National Railroad Passenger Corporation.

"(d) The provisions of this section shall not apply in any State which on the date of enactment of this section, has in effect a provision of its constitution (or an amendment thereto) which provides for the reasonable classification of property for State purposes.".

H.R. 10979

Sec. 601. Part I of the Interstate Commerce Act is amended by redesignating section 28, as redesignated by section 205 of this Act, as section 29, and by inserting immediately after section 27 the following new section:

DISCRIMINATORY STATE TAXATION

"Sec. 28. (1) Any of the following actions by any State, or subdivision or agency thereof, whether any such

action be taken pursuant to a constitutional provision, statute, or administrative order or practice, or otherwise, is declared to constitute an unreasonable and unjust discrimination against, and an undue burden upon, interstate commerce and is forbidden and declared to be unlawful:

"(a) The assessment (but only to the extent of any portion based on excessive values as hereinafter described in paragraph (3)), for purposes of a property tax levied by any taxing district, of transportation property owned or used by a carrier by railroad subject to this part at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other commercial and industrial property (located in the assessment jurisdiction of any State in which is included such taxing district and subject to a property tax levy) bears to the true market value of all such other commercial and industrial property.

"(b) The collection of any tax on the portion of such assessment so declared to be unlawful.

"(c) The collection of any ad valorem property tax on such transportation property at a tax rate higher than the tax rate generally applicable to commercial and industrial property in the taxing district.

"(d) The imposition of any other tax which results in discriminatory treatment of a carrier by railroad subject to this part.

"(2) As used in this section –

"(a) The term 'transportation property' means transportation property, as defined in the regulations of

the Commission, owned or used by a carrier by railroad subject to this part.

"(b) The term 'assessment jurisdiction' means a geographical area, such as a State, or a county, city, or township within a State, which is a unit for purposes of determining assessed value of property for ad valorem taxation.

"(c) The term 'commercial and industrial property' means property devoted to a commercial or industrial use, except that such term shall not include land used primarily for agricultural purposes or primarily for the purpose of growing timber.

"(d) The term 'all other property' means all property, real or personal other than transportation property and land used primarily for agricultural purposes or primarily for the purpose of growing timber.

"(3) In the event that the ratio of the assessed value of all other commercial and industrial property in the assessed jurisdiction to the true market value of all such other commercial and industrial property cannot be established through the random-sampling method known as a sales assessment ratio study, conducted in accordance with statistical principles applicable to such studies, to the satisfaction of the court hearing the complaint that transportation property has been or is being assessed or taxed in contravention of the provisions of this section, then it shall be unlawful (a) to assess such transportation property at a value which bears a higher ratio to the true market value of such transportation property than the assessed value of all other property (located in the assessment jurisdiction in which is

included such taxing district and subject to a property tax levy) bears to the true market value of all such other property, or (b) to collect any ad valorem property tax on such transportation property at a tax rate higher than the tax rate generally applicable to taxable property in the taxing district.

"(4) Notwithstanding the provisions of section 1341, title 28, United States Code, or of the constitution of laws of any State, the district courts of the United States shall have jurisdiction, upon complaint and after hearing, to issue such writs of injunction of other property process, mandatory or otherwise, as may be necessary to restrain any State, or subdivision or agency thereof, or any person from doing anything or performing any act declared by paragraph (1) to be unlawful, except that such jurisdiction shall not be exclusive of that which any Federal or State court may otherwise have. No relief shall be granted under this subsection unless the assessment percentage applied to transportation property exceeds by at least 5 per centum the assessment percentage applied to all other property in the assessment jurisdiction. The provisions of this section shall not become effective until 3 years after the date of its enactment.".

No. 4:90CV-60406

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

The Burlington Northern Railroad Company

Plaintiff,

vs.

Gerald D. Bair, Director of the
Department of Revenue of Iowa,

Defendant.

RULING AND ORDER

The Burlington Northern Railroad Company (BN or the railroad) brings this action under section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976 (§ 306 or 4-R Act), codified at 49 U.S.C. § 11503, against Gerald Bair, the Iowa Director of Revenue and Finance (Director), seeking relief from alleged discriminatory real property taxes for the 1989 assessment year. Section 306 prohibits the imposition of any discriminatory tax on railroads or rail property, confers federal court jurisdiction and creates an express federal injunctive remedy to enforce such prohibition.[1]

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[1] [Text of 49 U.S.C. § 11503 omitted.]

These same parties were involved in similar litigation in this court for tax years 1981 and 1982.[2] After remand from the Eighth Circuit Court of Appeals, this court, in an effort to determine the fair market value of BN's real property in Iowa, stated several principles to guide the parties in making necessary computations. The cases were settled without further litigation. Both parties claim to rely in this litigation upon those principles set forth by the court.

BN claims that the taxes assessed against it by the State of Iowa for the tax year 1989 violate section 306 in four respects:

A. The Director overvalued BN in violation of section 306(1)(a);

B. The Director undervalued comparative commercial and industrial property in violation of section 306(1)(a);

C. The Director improperly apportioned BN's value between real and personal property resulting in BN being assessed on tangible personal property in violation of section 306(1)(d);

D. The Director improperly taxed BN's intangibles compared with other commercial and industrial intangibles in violation of section 306 (1)(d).

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[2] *Burlington N. R.R. v. Bair*, 584 F. Supp. 1229 (S.D. Iowa 1984) (hereafter *Bair I*), *aff'd in part*, 766 F.2d 1222 (8th Cir. 1985) (hereafter *Bair II*), *on remand*, 648 F. Supp. 91 (S.D. Iowa 1986) (hereafter *Bair III*).

The Director denies that BN was discriminated against in any way by the real property tax imposed on BN by the State of Iowa.

Several factors combined make the resolutions of these claims complex and difficult. Although the parties agree that BN should be valued on a business enterprise basis as a unit, and they agree on the portion of that value assignable to the State of Iowa, the Director valued BN's rail transportation property at $4.9 billion while BN claims its true market value did not exceed $2.5 billion. The court must arrive at its own true market value. Because Iowa does not tax most of the personal property in the state, it is necessary to determine what portion of BN's true market value assigned to Iowa is personalty. It must also be determined whether intangible personal property is actually tax in Iowa, and if not, what can be considered intangible personalty and its value. The court must also determine what value the intangibles contribute to the true market value of BN's Iowa property. According to the Eighth Circuit Court of Appeals, it is the responsibility of this court to weigh the evidence and make its own factual findings regarding valuations. *Bair II*, 766 F.2d at 1225-26. A formidable task.

. . . .

IV.

INTANGIBLE PERSONAL PROPERTY DEDUCTION

When a railroad is valued as a unit on a business enterprise or going concern basis, that valuation necessarily includes intangible assets. If a state exempts most

personal property from ad valorem taxation, that exemption would include identifiable and quantifiable intangibles. In this case BN has identified and valued three kinds of intangible personal property: computer software, assembled work force, and long term coal hauling contracts.

BN claims that section 306 prohibits Iowa from including these intangibles in its valuation for tax purposes because Iowa does not tax intangible personal property of commercial and industrial taxpayers. The Director argues that going concern intangibles are assessed in Iowa as real property because of local assessors capture intangibles in the assessment of real estate. Therefore, BN has no claim under section 306 (1) (d) "even if methodologies for centrally assessed properties differ from commercial and industrial methodologies." The Director further argues that "the exclusion of *financial* intangibles from the [railroads'] unit value and the removal of personal property for railroads and the adjustments of the cost value for commercial and industrial real estate to account for sales price (by the county assessors) and sale ratios (by the Director) leave both parties similarly situated."

Assuming for the purposes of argument that such approach would leave the parties similarly situated, which is questionable, the evidence does not show that adjustments and sales ratios pick up the value of commercial and industrial intangibles. Computer software, assembled work force and coal contracts have some value that remains in BN's unit value and make some contribution toward the cash flow. The Director's evidence that

there are adjustments to the value of commercial and industrial real estate to account for the sales price to include such intangibles is not persuasive. The court holds that Iowa does not tax identifiable intangibles as real estate.

A. *Taxation of Commercial and Industrial Intangibles*

Section 441.21 (2), Code of Iowa, provides that "the special value or use value of the property to its present owner, and the good will or value of a business which uses the property as distinguish from the value of the property as property" shall not be considered in determining market value.

The railroad has been valued as a business and the intangible personal properties involved here are components of that value. It appears that the foregoing statute and Iowa case law, *Heritage Cablevision v. Board of Review*, 457 N.W. 2nd 594, 598 (Iowa 1990), prohibit the assessor from considering such intangibles when appraising commercial and industrial property. Thus BN is being discriminated against unless commercial and industrial intangibles are being taxed in violation of the statute.

In *Heritage*, the Iowa Supreme Court approved of the following statement from the district court.

> [W]hile the market approach method utilized by Kocer may have validity if he were attempting to determine the market value of the *system*, it does not follow that the method accurately determines the value of *taxable assets*. That is, the court concludes that the total fair market value of the system necessarily includes nontaxable assets such as a franchise to operate, an established customer base, experienced personnel in place, goodwill, and other intangibles.

Id. at 598.

The supreme court then said:

> We believe the district court's conclusion concerning these comparable sales was valid. The evidence suggests that a cable television system, as a going business enterprise, can generate tremendous income for the owners. We believe that the valuations which Kocer derived from these sales failed to exclude the substantial value which the buyers were receiving from the business enterprise with which the taxable assets were associated. Kocer attempted to determine that portion of the total price paid for other cable television systems as going concerns which was attributable to the taxable assets. He did so by taking the franchise fee payable to the governmental body, capitalizing that sum and subtracting the latter figure from the total sale price. We do not believe this adjustment produced a figure which is in any way representative of the fair and reasonable exchange between a willing buyer and willing seller of only the taxable assets.

Id. at 599.

The Director relies heavily on *Maytag Co. v. Partridge*, 210 N.W. 2nd 584, 590 (Iowa 1973). At that time section 428.22 of the Iowa Code provided that machinery used in manufacturing establishments shall for the purpose of taxation be regarded as real estate. The issues in *Maytag* were quite different. Maytag argued that machinery used

in its operation should be valued and taxed at the market price of used machinery for sale. The Iowa Supreme Court rejected this claim and approved of the assessor recognizing the effect of the machinery's use on the value of the property itself. *Maytag* acknowledged that intangibles were not to be taxed. *Id.* at 590.

In *Heritage* the court said:

> The application of the "going concern" principle in *Maytag Co.* was in the context of rejecting the property owner's claim that its machinery should be valued exclusively by a market data analysis of the used machinery market. We approved the assessor's depreciated cost appraisal in that case under the "other factors" approach. We did not suggest in *Maytag Co.* that in trying to value taxable assets under a comparable sales analysis the statutory directives against considering "special value or use value of the property to its present owner, and the goodwill or value of a business which uses the property as distinguished from the value of the property as property" may be disregarded.

Heritage, 457 N.W. 2nd at 599.

The Director introduced testimony from local assessors and state officials attempting to show that the Declarations of Value included intangibles in the purchase price of real estate. The forms, if properly completed, would not include intangibles because they ask the price for real property only. If an intangible is listed, its cost is deducted from the total price. Intangibles may advertently be included in the gross price if not identified with a price. However, that in the court's opinion does not

change Iowa law that intangibles are not to be taxed as real estate.

The court rejects the Director's argument that intangibles are in fact taxed as part of the real estate in Iowa. The Iowa tax system does not tax intangible property as such.

B. *Value of Intangible Assets*

BN's experts identified intangible assets that contributed to BN's value as a business enterprise. The cost approach was used to value BN's computer software ($176,000,000) and assembled work force ($233,000,000). The income approach was used to value the coal contracts ($263,000,000). The experts deducted these determined values dollar for dollar from their computed $2.5 billion for the system as a whole. It is acceptable to use the cost approach to arrive at values for the computer software and the work force in place. The income approach is an appropriate way to value the coal contracts. But the dollar for dollar deductions from the unit value of the railroad is not the proper method to arrive at the value of BN's real property. Use of this procedure would mean that the value of BN's real estate would be whatever value is left after the computed values of tangible and intangible personal property are deducted from the unit value. For example, combining all of the claims advanced by BN in this litigation you come up with this very questionable result.

Unit value of the railroad	$2,500,000,000
Less 50% as personal property	$1,250,000,000
	$1,250,000,000
Less value of intangibles	$ 672,000,000
Value of real estate	$ 578,000,000

This value for BN's operating real property is ridiculous. It operates one of the largest railroad systems in the United States. BN's system consists of 23,500 miles of operating track connecting the Midwest, the Pacific Northwest and the Gulf Coast. Under BN's approach the value of all its operating real property would be considerably less than the value of the identified intangibles, although the book value of the railroad real property is $3,500,000,000.[3]

The value of BN's real estate cannot be determined by accepting the remainder of the unit value of BN after the values of these intangibles is computed and deducted. If separate values had been determined for the real property as well as tangible and intangible personal properties and all three added together and the result proportioned, it would have made some sense. But to say the value of the real estate is just what is left, is unacceptable. There is no proof of the relationship between these values and the market value of the railroad whether the income or stock and debt indicators are used. There is no proof of the contribution these intangibles made to the cash flow

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[3] From page 7, Exhibit 61 –

Net book value of the system	$5,798,249,686
Less personal property and operating leases	2,299,220,686
	$3,499,029,000

or the price of the stock. The court cannot accept the proposition that every dollar of their value went into the cash flow or stock price.

The court could therefore hold that BN has failed to establish by a preponderance of the evidence the contribution that these intangibles made toward the cash flow or the price of the stock of BN and deny it any relief from the state's taxation of these identified intangibles. However, these intangibles do have some value that should be recognized and the court believes there is evidence in the record by which their contribution to the cash flow and stock price can be considered, although there is no expert testimony supporting this analysis.

Why shouldn't intangible personal property be broken out of the unit value the same way tangible personal property is? Book values were used to determine the proportion of unit value represented by tangible personal property. BN's expert conceded that this is not a good method, but it is the best available method of taking particular assets out of the unit value. See footnote 12. The court will use the book values of the BN railroad and add the computed values of the intangibles, which have no book value, determine the percentage applicable to the intangibles and allow that percent as a deduction from true market value.[4] The net book values are taken from

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[4] I realize that I am off on a "frolic of my own" in taking this approach but I am convinced it is the best result. I also realize I am combining book value with appraisals of true market value, but I could not accept the dollar for dollar deduction but I know the intangibles contributed to BN's value.

I also recognize that the valuation of intangibles will pose a serious problem for the Director. The expense of arriving at a

page 7 of Exhibit 61. The proportion attributable to intangibles is ten percent and the allowable deduction is $67,200,000.[5]

. . . .

VI

SUMMARY

In summary, I find and hold that:

. . . .

16. Computer software, assembled work force and long term coal contracts are intangible assets that contribute to the value of BN.

17. Iowa does not tax intangible property as part of commercial and industrial real estate. Therefore, whatever value the railroad's intangibles contribute to BN's value as a business enterprise should not be taxed.

18. The appraised value of the intangibles cannot be deducted dollar for dollar from the true market value of BN as a business enterprise.

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value for these assets that have no intrinsic value will be great. But, I do not see any way to avoid acknowledging that they have a value that should not be taxed as part of the real estate.

5

Net book value	5,798,249,686
Add value of intangibles	672,000,000
Total value	$6,470,249,686
Value of intangibles / Total Value =	672,000,000 / $6,470,000,000 = 10.3%
	Round to 10%

19. Use of the net book cost basis to determine the proportion of BN's true market value attributable to these intangible assets results in ten percent of their appraised value or $67,200,000.

. . . .

The court has, with trepidation, made the foregoing calculations. However, the remaining calculations will be left to the expertise of the parties using the court's findings and holdings.

I cannot conclude this opinion without offering some gratuitous advice to the railroads, the states and the federal government. The 4-R Act was enacted to protect the railroads from discriminatory taxation by the states, a valid concern. However, the statute, as it now stands, has spawned considerable and very expensive litigation. The issues of national significance should be resolved on an national level. Different states should not have different unit values for the same interstate railroad. The percentage of that value consisting of tangible and intangible personal property for the specific railroad should be the same throughout the country. The statute should be amended to give the Interstate Commerce Commission, or other appropriate board or commission the authority and duty to value all interstate railroads and determine the percentages of that value attributable to tangible and intangible personal property. The states and the railroad should have input during the evaluation procedure and the right to appeal. But these issues should be resolved in one lawsuit between the interested states and the railroad. Those issues relating to taxation in a specific state,

like equalization, could still be tried in federal court in the state involved.

The changes suggested should save the railroads and the states considerable sums of money, treat all states and railroads equally and reduce the burden on federal courts.

The court directs BN to take the responsibility for the preparation of Order for Judgment in accordance with this Ruling and Order. It shall be submitted to the Director for his approval and then submitted to the court. If there is disagreement over the contents of such an order, the matter will be resolved by the court.

IT IS SO ORDERED.

Signed this ___ day of March, 1993.

/s/ _____
W. C. STUART, Senior Judge
Southern District of Iowa.
